STARTUP
FUNDING

SJOERD MOL & THOMAS MENSINK

STARTUP FUNDING

ALL ABOUT VENTURE CAPITAL
AND HOW TO RAISE IT

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ABOUT THE AUTHORS

SJOERD MOL has more than fifteen years of experience in startup financing. As a partner at the law firm Benvalor, he assists entrepreneurs and investors in venture capital transactions. He was involved in over one hundred startup investment deals. Sjoerd is co-founder of Capital Waters, a pro-bono initiative to make standard deal documentation available for startups and investors. Sjoerd is also co-author of *Venture Capital Deal Terms: negotiating and structuring your venture capital transaction*, which is an Amazon Best Seller in Venture Capital. He is involved as a mentor and advisor in several incubators and accelerators and is a member of the BOM Brabant Ventures investment committee. Sjoerd also has extensive experience as an M&A lawyer and is regularly involved in setting up investment funds. Sjoerd studied Law and Law & Economics at Utrecht University.

THOMAS MENSINK is a startup and investment analyst at Golden Egg Check. He wrote his thesis on investor criteria (which formed the fundament of Golden Egg Check's startup assessment methodology) and has been infinitely interested in the world of venture capital ever since. Thomas collects and analyzes data on venture capital investments. He helps startups increase their investor readiness and connect with relevant investors. He also works as a scout for a number of venture capital firms. Since 2022, he runs Golden Egg Check Capital, a co-investment fund to invest in startups together with other venture capitalists. Although Thomas regularly writes blog posts about startups and venture capital, *Startup Funding* is his first book. He also hosts the *At The Money* podcast, in which he discusses growth and investment strategies with founders and investors. Thomas studied Industrial Engineering & Management and Financial Engineering at the University of Twente.

FOREWORD

″Aren't you the guy from that interesting podcast?″, and, ″You write those nice articles on deal terms, right?″ That′s how we got to know each other. For years we moved past each other in the Dutch startup scene until we met some years ago at a startup party. Apart from a passion for growth companies and financing them, we discovered that our knowledge, experience and backgrounds were a huge fit. Thus, we got further into conversation. ″How nice it would be to write a book that brings together our knowledge and experience,″ we said.

And that′s what we did. We wrote a book about the context of a venture capital deal. Who are the players? How do venture capital funds work? What are they looking for? What are the important deal terms? How does the process work? It has become a book that is above all very practical. It offers a manual to startups that want to raise money: it describes from A to Z how to go about it.

Initially we wrote this book in Dutch, our native language, but we soon noticed that there was also a need for an international version. We therefore took our Dutch book as the basis for this English edition, and adapted it, updated it and made it relevant for an international audience. We have incorporated insights from entrepreneurs, investors and lawyers from the U.S., Germany, Sweden, Finland, Austria and Nigeria, among others. In doing so, we also hope to provide some counterweight to all the books on venture capital coming out of the U.S., which is after all a market with specific characteristics that may be less valid elsewhere.

We wrote the book primarily for first-time entrepreneurs who want to raise money from venture capital investors. At the same time, we think the book will be of interest to a much broader group, such as entrepreneurs who are not yet ready to raise money but want to orientate themselves to what is to come. We also hope that this book offers interesting insights to more experienced venture capital investors, serial entrepreneurs, angel investors, lawyers, incubators, coaches, students and basically anyone interested in startup funding.

Although we took the startup seeking to raise money as the viewpoint of this book, we have tried to provide a balanced perspective between startups and investors with regard to deal terms and other items of the fundraising process. We believe that the interests of startups and investors are much more parallel than is sometimes thought. After all, both have the same goal: to make the venture a great success.

Startups are the future. As a startup, you are trying to create something, challenge the status quo and change the world because you think something can be done better, faster, cheaper, prettier or more sustainable. The right investors can be invaluable in achieving these goals. With this book, we hope to contribute – however small – to your startup, to the startup ecosystem and indirectly to the future of this world.

The rest is up to you...

Go for it. Make the magic happen!

Sjoerd Mol and Thomas Mensink
Utrecht / Amersfoort (the Netherlands), August 2023

PS. When you have read this book and it has helped you get an investment, we would appreciate it if you tell other entrepreneurs about this book. You can do this through a review on our website (www.startupfundingbook.nl) or at the platform where you bought the book. That way we hope to help more entrepreneurs with their startup funding. Thank you!

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"This book is a primer on fundraising. It levels the information asymmetry between founders and investors. Founders need to think like investors because they invest their most valuable resource (time) into their projects. This book shows you how."

Ash Maurya, author of Running Lean

INTRODUCTION

Access to capital is crucial to the success of a startup. Hence, at some point, many entrepreneurs consider engaging with venture capital from angel investors or professional venture capital firms. This is not an easy decision. Venture capital can offer you a lot, but it also brings pressure and expectations. We hope that through this book, we can guide you as an entrepreneur through this area. In this way, we hope to create a level playing field between you and the investors you will encounter, where you can make a good impression and successfully obtain the financing you are looking for.

In this book, we take you, step by step, through the various stages of the fundraising process. It begins in Chapter 1 with an explanation of the different forms of startup funding and the business model of a venture capital investor. In Chapter 2, we move on to investor readiness. Is your startup ready for a venture capital investment? We tell you how an investor looks at startups when evaluating the investment opportunity. In Chapter 3, we outline how to prepare for meetings with investors, make a good pitch deck, and connect with the right investors.

Next, Chapter 4 covers the term sheet. We go into detail about all the important provisions that appear in it. Here we distinguish between economic rights and the control rights required by investors. In this chapter, we also cover various forms of employee incentive plans used by startups. Then in Chapter 5, we cover the process of getting from a term sheet to a deal, and we describe what happens next, once the deal is closed. This chapter also includes a section on negotiating and raising follow-on funding. Finally, in Chapter 6, we discuss an exit through a trade sale or listing. What is this process like, and how do you prepare for it?

Personal insights

Many sections conclude with our personal insights or key points of interest. These are marked with an icon of a light bulb. In addition, we have included insights from entrepreneurs and investors. Many of them were guests on Thomas' At The Money podcast.

In a book about startups and venture capital, there is no escaping the constant use of technical terms. We briefly explain the terms the first time we use them, and they can also be found in the glossary at the back of the book (the 'venture capital lingo'). A standard term sheet is also included as an appendix. You can find even more information, including updates, a Word version of the term sheet, on our website, www.startupfundingbook.nl.

All deals are different

We have done our best to give a complete picture of what you can encounter in real life and what approach it requires, but this book will not contain all the answers. All deals are different; not one is equal to another. Moreover, we, the authors, are influenced by our own experiences with fundraising and venture capital transactions, and we are mostly active in Europe and the Netherlands in particular. Fortunately, you can also take a look at other books, courses, and websites on the subject. Please do so and help each other get better and smarter.

We have reread the book many times to get the last flaws out of it, but no doubt there will still be some inaccuracies. Please email us if you find anything incorrect (mol@benvalor.com or thomas@goldeneggcheck.com), and we will improve it in the next version. We also like to hear if you have other insights than what you have read here!

Finally, perhaps good to mention, we use 'they' and 'their' as a reference to an investor, a founder, an entrepreneur, or any other functionary mentioned in the book. To us, using 'he' or 'him' as a default does not represent the full diversity of today's startup and venture capital landscape.

We hope this book will help make your business successful and hope you will enjoy reading!

1.

VENTURE CAPITAL

1.1 RAISING VENTURE CAPITAL

Venture capital can deliver a world of opportunity. First and foremost, of course, is the financing, which enables you to realize your plans (hiring personnel, carrying out operations, marketing, etc.). However, investors can provide much more than money. They share their network and their expertise, they provide strategic advice on your organization, growth, internationalization, and more. All of which can be incredibly valuable to a founder.

Your reputation

Venture capital can also benefit your company's reputation, provided that respectable investors step in. Outside investors who commit themselves to the success of your company serve as a powerful signal making it easier to attract potential employees, customers, and follow-up investors. The combination is compelling: a recent round of capital, alongside people with experience and expertise who have taken the effort to look carefully at your company and think: there is a future in this!

Bootstrapping

Instead of taking on venture capital, a company can also propel growth by investing its own revenues, called *bootstrapping*. In fact, it can be wise to grow under your own steam and keep venture capital investors out for as long as possible. This allows you to keep full control of your business and thus retain the freedom to decide what to do.

Focus

Bootstrapping also necessitates focus. If your resources are scarce, you must use them as effectively as possible, by listening carefully to your customers and focusing on what creates value for them (and how to monetize that value). It also forces you to keep your product and organization simple and avoid unnecessary expenditures. Scarcity can be a powerful tool, making you creative and providing a need to prioritize your 'product-market fit' and revenue generation. Additionally, a bootstrapped budget likely does not allow a company to hire too many people, so the team stays relatively small and manageable. This makes it easier to learn quickly as an organization and adjust as needed.

Money can disguise a problem

Spending money is one thing, but can you turn it into value? Scaling up too early or too fast is one of the main reasons why startups fail. Money can disguise that a business model doesn't quite work yet. For example, you can spend a lot of money on marketing to bring in new customers (growth!), but if those customers quickly drop out because their needs are not being met properly, it's like filling a bucket full of holes.

Initial bootstrapping can help you learn how to spend money (your own or, later, an investor's) most meaningfully. We know startups that grow as fast by bootstrapping as their competitors that raised large amounts of external capital. As you can imagine, the latter group might expect critical questions from their investors.

Fond of traction

In addition to the freedom and focus bootstrapping gives, it can help you demonstrate that your business model is viable. You must focus on generating revenue because that provides the money you need to keep your organization running. You can only generate revenue if you can solve a customer's problem or meet their needs. If more and more people or companies are willing to pay for your product, that is called *traction*. And if there's one thing many investors love, it is traction. By validating your proposition in the market and demonstrating (organic) sales growth, you make your company more interesting to investors. And because you have already reduced the risks in your business model (by finding out whether there is market demand, whether you offer a scalable solution, whether customers are satisfied, etc.), your company has become more valuable. Creating traction early is easier for a software company than for a high-tech or biotech startup. Still, in many cases, you can do something early on to attract paying customers, or at least commitments.